Dr. Simon, my home telephone number is (630) 972-2152. Please feel free to call anytime. Thank You.

NORTHERN ILLINOIS UNIVERSITY

How Are Companies Complying With Financial Accounting Standard 121 "Impairment of Long-Lived Assets"?

A Thesis Submitted to the

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by Marzena R. Matz

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Student Name: Marzena R. Matz

Approved by: John R. Simon

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HONORS THESIS ABSTRACT
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ABSTRACT (100-200 WORDS):

Statement of Financial Accounting Standard (SFAS) 121 is a new standard devoted to the issue of impairment of long-lived assets. Impairment loss occurs when the carrying amount is not expected to be recovered. When SFAS 121 was issued, early adoption was suggested but not required for fiscal years beginning before December 15, 1995. Although there are some similarities, the standard sets some different rules for assets "to be held and used" and assets "to be disposed of." Since the standard does not identify a materiality level, it remains at the discretion of management.

This paper first discusses the requirements of SFAS 121. Then a sample of companies is analyzed to determine compliance with the new standard. A sample of 25 companies was chosen from the CD-ROM Disclosure Software. The sample was analyzed and compared on a list of items to identify relationship between the items and to identify if, how and when companies plan to comply with SFAS 121. Some of the items noted were year ends, early adoption of SFAS 121, type of impairment, discussion in the management representation letter and discussion in the footnotes to the financial statements.

INTRODUCTION

Accounting bodies like the Financial Accounting Standards Board (FASB) established rules and regulations for financial reporting requirements of various accounting topics related to publicly held corporations. Recently a standard was issued on how to account for the impairment of long lived assets. The purpose of this paper is to examine how companies are reporting asset impairments and if they are in compliance with this new standard.

What is an asset? The Financial Accounting Standards Board in the Statement of Financial Accounting Concepts No. 6 (1985) defines assets as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. [ix]" What does it mean when an asset is impaired? Statement of Financial Accounting Standards 121 explains that an asset impairment occurs when the carrying amount of an asset is not recoverable and a write-off is needed. [544] Discussed later are examples of events and circumstances that may lead to an impairment. This paper is organized in three main parts. The first part describes the standard and required compliance. The second part explains how I gathered my data on the compliance of 25 randomly selected companies. The last part shows an evaluation of the data.

Why would a company ever want to take an impairment loss? Alfred M. King (1996) explained that after a major write-down in assets, often a company's stock price will rise. The write-down shows that management is keeping aware of situations and takes actions to correct necessary situations. The "big bath" theory makes sense here, because if an entity is going to take a write-down, it might as well take a large one. King explains the reasoning for applying the "big bath" theory to asset impairments:

> "While there is no assurance of future profits, it is far more likely that profits will be reported in the future if the cause of past losses is eliminated. That is why a current operating or cash flow loss is the most likely indicator of when an asset impairment has to be recognized. Neither management nor shareholders likes losses. Getting rid of losses, however, is good. [27]"

Companies have employed diverse practices to measure and recognize impaired assets. The AICPA Accounting Standards Executive Committee and the FASB Emerging Issues Task Force and others have addressed the issue but have never issued an authoritative pronouncement. Finally in March of 1995, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of.* This is the first authoritative pronouncement devoted to the issue of impairment of long-term tangible and intangible assets and related goodwill. SFAS No. 121 applies to all entities including regulatory and non-for-profit organizations. It does not apply to certain other assets. Some of the excluded assets are assets of financial institutions, deferred tax assets, equity investments, mortgage servicing rights, specialized industry assets covered by other standards, or assets being disposed of as part of discontinued operations in accordance with Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations.*

SFAS No. 121 covers two groups of assets and has different rules for the accounting of the two groups. These groups include:

- Long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used; and

- Long-lived assets and certain identifiable intangibles to be disposed of.

SFAS 121 is effective for financial statements for fiscal years beginning after December 15, 1995. Early adoption is encouraged. Restatement of previously issued financial statements is not allowed.

ASSETS TO BE HELD AND USED – General Principles

According to Dorsey L. Baskin Jr. (1995), the FASB decided that if management's intent is to hold and use long-lived assets, these assets do not have to be reviewed at each reporting date. The assets only need to be reviewed when an event or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The FASB listed the following examples of such events or circumstances in paragraph 5 of SFAS 121:

- A significant decrease in the market value of an asset;
- A significant change in the extent or manner in which an asset is used or a significant physical change in an asset;
- A significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator;
- An accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset; and
- A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with an asset used for the purpose of producing revenue.

The FASB also cited an AICPA Issues Paper, *Accounting for the Inability to Fully Recover the Carrying Amounts of Long-Lived Assets*, which lists similar examples which includes:

- Reduction in the extent to which a plant is used;
- Dramatic change in the manner in which an asset is used;
- Substantial drop in the market value of an asset;
- Change in law or environment;
- Forecast showing lack of long-term profitability; and
- Costs in excess of amount originally expected to acquire or construct an asset.

Paul Munter (1995) believes that through these examples, the FASB requires that management monitor its operations continuously in order to be aware of problems that may lead to improper valuation of long-lived assets.

ASSETS TO BE HELD AND USED - Trigger

The previous events do not guarantee a write-down for impairment, but their occurrence does require that a full test for impairment be performed. This test for impairment, or trigger, is an undiscounted cash flow test ignoring interest charges. According to Baskin (1995), the test using undiscounted cash flows ignoring interest charges "permits moderate, and perhaps temporary, depreciation in value to not be recognized and, while it does require estimating of future net cash flows, it does not require an appraisal of the asset's fair value. [2]" Future net cash flows are estimated and compared with the carrying amount to determine if the carrying amount can be expected to be recovered. Example 1 below demonstrates this issue. However Baskin noted that

"...when an impairment loss is triggered, it leads to a larger loss amount *in that period* than if the loss had begun to be recognized earlier because of a faster trigger. [3]" The following Baskin [4] example displays the previous items.

Example 1:

Assumpitons:

Asset	$1,500,000	Related Nonrecourse Debt	$1,400,000

The lender does not account for the loan as an acquisition, development, and construction loan. Principal and interest on the debt is $164,443 per year with a 20-year amortization with a fixed rate of 10% and total payments of $3,288,869. All cash flows available to the owners are first used to service the debt.
Current fair market interest rate is 12%.

			SFAS 121 – Owner			
Scenario	Annual Cash Flow	Total Undiscounted Cash Flow(A)	Owner Impaired	Carrying Amount(B)	Impairment Loss(C)	SFAS 121 Impairment Percentage
1	$164,443	$3,288,869	No	$1,500,000	None	0%
2	$160,000	$3,200,000	No	$1,500,000	None	0%
3	$120,000	$2,400,000	No	$1,500,000	None	0%
4	$80,000	$1,600,000	No	$1,500,000	None	0%
5	$70,000	$1,400,000	Yes	$522,861	$977,139	65%
6	$40,000	$800,000	Yes	$298,778	$1,201,222	80%
7	$0	$0	Yes	$0	$1,500,000	100%

(A) 20 times annual cash flow

(B) $1,500,000 unless scenario indicates impairment, then amount is 20 times annual cash flows discounted at the market interest rate (12%)

(C) When an impairment loss exists, it equals $1,500,000 - (B)

A faster trigger is demonstrated in Example 2 question 3.

ASSETS TO BE HELD AND USED - Cash Flows and the Recognition of an Impairment Loss

Some guidance is provided in SFAS 121 on which future cash flows to consider. An estimate of the future cash flows expected to result from the use of the asset and its eventual disposition needs to be considered. The future cash inflows expected to be generated by the asset less the future cash outflows expected to be necessary to obtain those inflows equal the net future cash inflows. The estimates should be based on reasonable, supportable assumptions and projections. An impairment loss must be recognized when the total of undiscounted future cash flows, ignoring interest charges, is less than the carrying amount of the asset. If this is not the case, an impairment loss is not triggered, but it is recommended that a review of depreciation policies be conducted. According to Baskin (1995), "the FASB makes a distinction between "depreciation" (an allocation of recoverable costs among periods) and "recognizing impairment" (a downward adjustment of the carrying amount to an amount that is expected to be recoverable in future periods). [3]"

The FASB does not give specific guidelines for determining the length of the future period to use while estimating cash flow projections. Munter (1995) explained that the length of time the entity expects to use the assets could be used for the future period. However, a problem arises when a grouping of assets is used where the assets might have different expected lives. Grouping of assets is discussed later.

ASSETS TO BE HELD AND USED - Fair Value and Measurement of Impairment Loss

The Example 2 demonstrates a situation when the recognition of impairment loss is required under SFAS 121. The situation in Example 2 also shows the measurement of an impairment loss.

Example 2:

The following can be assumed for ABC Manufacturing Company during December 1996. There was a significant decrease in the market value of its equipment used in its manufacturing process. At December 31, 1996, ABC compiled the information below:

♦ Original cost of equipment	$500,000
♦ Accumulated depreciation	300,000
♦ Expected net future cash inflows (undiscounted) related to the continued use and eventual disposal of the equipment	175,000
♦ Fair value of the equipment	125,000

1. Should ABC recognize an impairment loss on the equipment under SFAS 121? And why?
   Yes. The equipment significantly decreased in market value. This is one of the indicators that the carrying amount may not be recoverable. The impairment loss must be recognized, because the expected undiscounted net future cash inflows are less than the carrying amount of the asset.

2. What amount of impairment loss should be reported on ABC's income statement prepared for the year ended December 31, 1996?
   $75,000

Carrying amount of the equipement on 12/31/96	*$200,000*
Fair value of the equipment on 12/31/96	*125,000*
Impairment loss reported on 1996 income statement	*$ 75,000*

3. If in 1995 due to a faster trigger an impairment loss was recognized for $40,000, what amount of impairment loss would be recognized in 1996?
   $35,000

Carrying amount of equipment on 12/31/95	*$200,000*
1995 Impairment loss	*40,000*
Carrying amount of equipment on 12/31/96	*160,000*
Fair value of equipment on 12/31/96	*125,000*
Impairment loss reported in 1996	*$ 35,000*

Note the difference between the answers to questions 2. and 3.* ***Question 3 has a faster trigger that requires impairment loss recognition in a prior period (1995.) *Therefore, the impairment loss in question 3.* ***is less than the impairment loss*** *in question 2 for the same period (1996.)*

An impairment loss should be measured using the asset's fair value. According to Baskin (1995), the FASB feels that "a decision to continue to operate rather than to sell an impaired asset is economically similar to a decision to invest in that asset and, therefore, the impaired asset should be measured at its fair value. [3]" The impairment loss can not be reversed, because the asset's new cost basis equals the asset's fair value.

SFAS 121 also provides guidelines for measuring fair value. Fair value is defined as the amount at which an asset could be bought or sold in a current transaction between willing parties, other than in a forced or liquidation sale. The Statement further says that a quoted market price in an active market is the best evidence of fair value and must be used for the measurement if it is available. If this price is not available, then the best information available in the circumstances must be used to estimate fair value. The estimate of fair value must consider prices for similar assets and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques provided in the statement include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis.

ASSETS TO BE HELD AND USED - Selling Costs

Depending on the classification of the impairment, selling costs may or may not have to be considered. Selling costs are the direct costs to transact the sale of the asset. Examples of selling costs includes broker commissions, legal and title transfer fees, and closing costs. SFAS 121 does not require that selling costs be subtracted from fair value for assets "to be held and used". However for the assets "to be disposed of", SFAS 121 does require that selling costs be subtracted.

Once again Example 2 can be used with a couple modifications to demonstrate the effects of selling costs on impairment loss.

Assume for this section that ABC's equipment is an asset "to be disposed of." The following is additional information compiled at December 31, 1996 regarding the direct costs to transact the sale of the equipment:

♦ broker commissions	$10,000
♦ legal and title transfer fees	$ 5,000
	$15,000

4. What amount of impairment loss should be reported on ABC's income statement prepared for the year ended December 31, 1996

$75,000

Carrying amount of the equipement on 12/31/96		*$200,000*
Fair value of the equipment on 12/31/96	*125,000*	
Direct costs to transact sale of equipment	*15,000*	
		110,000
Impairment loss reported on 1996 income statement		*$ 90,000*

ASSETS TO BE HELD AND USED - Grouping

Sometimes it may be hard to separate the cash flows of related assets. According to paragraph 8 of SFAS 121, assets must be grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets. But what if an asset does not have identifiable cash flows that are largely independent of other asset groupings? The impairment loss must be recognized if the sum of the expected future cash flows (undiscounted and without interest charges) for the entity is less than the carrying amounts of the entity's assets covered by SFAS 121.

ASSETS TO BE HELD AND USED - Goodwill

If the long-lived asset or group of long-lived assets being tested were acquired in a business combination accounted for using the purchase method, the FASB set up special rules for unamortized goodwill. The unamortized goodwill that arose in that transaction must be included as part of the asset grouping in determining whether impairment exists and in measuring impairment. If some but not all of the assets acquired in the transaction are being tested, goodwill must be allocated to the asset being tested on a pro rata basis unless a more appropriate method of associating goodwill with the assets exists. Baskin (1995) disagrees with the FASB on this issue and explained his reasoning as:

> "despite what the Statement may be interpreted to say, it makes no sense to allocate goodwill only among the assets being tested for impairment. The FASB may intend that all of the unamortized goodwill associated with a purchase business combination should be allocated among all of the assets acquired, including the assets not being tested. Aside from the mechanical aspects of the test, no conceptual basis is articulated by the FASB for the process of allocating an asset that could not be identified at the time of the transaction (i.e., goodwill) among the assets that were identified. The FASB does say that goodwill not identified with impaired assets should continue to be accounted for under Opinion 17. [7]"

ASSETS TO BE HELD AND USED - Early Warning Disclosures

SFAS 121 does not require early warning disclosures. However, early warning disclosure may be required under SOP 94-6 issued by the AICPA. Baskin (1995) concluded that "whenever a review for the recoverability of a material asset or asset group is triggered by events or changes in circumstances, regardless of whether impairment is recognized at that time, a review of the need for disclosure of the "significant estimates" inherent in assessing the asset's recoverability would likely be required under SOP 94-6 [*Disclosures of Certain Significant Risks and Uncertainties*]. [8]"

ASSETS TO BE HELD AND USED - Reporting and Disclosure

In SFAS 121, the FASB describes different reporting and disclosure requirements for assets "to be held and used" and assets "to be disposed of." For the "to be held and used" assets, impairment losses must be reported as a component of income from continuing operations before income taxes. If a subtotal such as "income from operations" is used in the income statement, that subtotal must include the impairment loss. Retroactive application of SFAS 121 is prohibited. If there are material impairment losses, there are a number of required disclosure items in the financial statements. These disclosures are listed in Table 1. However, the FASB does not specify a definition or an amount for materiality. What is material is based upon the judgement of the management of the company. The information from the original Example 2 is used below to demonstrate the income statement of ABC with an impairment loss on an asset "to be held and used."

The original amounts from Example 2 are used in the following income statement. All other amounts are assumed.

ABC Manufacturing Company
Income Statement
For The Period Ended December 31, 1996

Net sales	1,000,000	
Other income	250,000	
Total revenue		1,250,000
Costs and expenses:		
Material, labor and other production costs	500,000	
Selling, distribution and marketing	50,000	
Asset Impairment Loss	*75,000*	
Interest	25,000	
		650,000
Income before income taxes and cumulative effect of accounting changes		600,000
Income Taxes		200,000
Income before cumulative effect of accounting changes		400,000
Cumulative effect of accounting changes, net of tax of $10,000		50,000
Net income		350,000

ASSETS TO BE DISPOSED OF – General Principles

The FASB identified separate rules for assets "to be disposed of". There is no separate trigger for these assets. Long-lived assets considered assets "to be disposed of" include assets that will be disposed of through sale or abandonment and assets that do not have any future service potential. Once assets are designated as "to be disposed of", they must be evaluated for impairment.

ASSETS TO BE DISPOSED OF - Measurement

The assets "to be disposed of" must be reported at the lower of carrying amount or fair value, less costs to sell. Carrying amount is the acquisition cost or other basis less accumulated depreciation or amortization and less any valuation adjustment account established at the time or after the asset is deemed "to be disposed of." The same guidelines exist for measuring fair value as for the assets "to be held and used." The information in the original Example 2 with one modification can be used to help demonstrate this section.

Assume the same information as in the original Example 2 except that the equipment is an asset "to be disposed of."

5. What amount of impairment loss should be reported on ABC's income statement prepared for the year ended December 31, 1996?
   $75,000

Carrying amount of the equipement on 12/31/96	*$200,000*
Fair value of the equipment on 12/31/96	*125,000*
Impairment loss reported on 1996 income statement	*$ 75,000*

There is a significant difference for assets "to be disposed of." The valuation adjustment account recorded at or after the time an asset is deemed "to be disposed of" should be reversed if evidence indicates that the fair value has been recovered. Recall that due to the write down of assets "to be held and used" a reversal is not allowed. "To be disposed of" assets can no longer be depreciated once identified even if they are used before they are disposed of.

ASSETS TO BE DISPOSED OF - Fair Value

In SFAS 121, the FASB described standards for the fair value of assets "to be disposed of." The paragraph 16 states that:

> "if the fair value of an asset is measured by the current market value or by using the current selling price for a similar asset, that fair value shall be considered to be a current amount and that fair value and cost to sell shall not be discounted. If the fair value of an asset is measured by discounting expected future cash flows and if the sale is expected to occur beyond one year, the cost to sell also shall be discounted."

This differs from the treatment of assets "to be held and used" where discounting is never used.

ASSETS TO BE DISPOSED OF - Cost to Sell

As for the assets "to be held and used", cost to sell includes incremental direct cost to transact the sales of the asset. The FASB did exclude the following costs, which should be expensed as incurred, from cost to sell: insurance, security services, utility expenses, and other costs of protecting and maintaining the asset. These costs will be allowed to be included as adjustments to the cost to sell if the entity enters into an agreement to sell an asset that obligates the entity to incur such costs in the future to effect the sale.

ASSETS TO BE DISPOSED OF - Related Goodwill

SFAS 121 did not set up any new standards for goodwill related to assets "to be disposed of." SFAS 121 does refer to paragraph 32 of Opinion 17, which states:

> "ordinarily goodwill and similar intangible assets cannot be disposed of apart from the enterprise as a whole. However, a large segment or separable group of assets of an acquired company or the entire acquired company may be sold or otherwise liquidated, and all or a portion of the unamortized cost of the goodwill recognized in the acquisition should be included in the cost of the assets sold."

ASSETS TO BE DISPOSED OF - Reporting and Disclosure

Reporting and disclosure for assets "to be disposed of" is similar but different from the requirements for assets "to be held and used." Gains and losses should be reported as a component of income from continuing operations before income taxes. If a subtotal such as "income from operations" is used in the income statement, that subtotal must include the impairment loss. The initial application of SFAS 121 for assets "to be disposed of" should be reported as the cumulative effect of a change in accounting principle, as described in Opinion 20. Retroactive application of SFAS 121 is prohibited. If an entity holds a material amount of assets "to be disposed of", there are a number of required disclosure items in the financial statements. These disclosures are listed in Table 1. The previous Example 2 income statement for ABC has been modified below to include an initial application of SFAS 121 for assets "to be disposed of." The original income statement included assets "to be held and used."

All of the following numbers are assumed.

ABC Manufacturing Company
Income Statement
For The Period Ended December 31, 1996

Net sales	1,000,000	
Other income	250,000	
Total revenue		1,250,000
Costs and expenses:		
Material, labor and other production costs	500,000	
Selling, distribution and marketing	50,000	
Interest	25,000	
		575,000
Income before income taxes and cumulative effect of change in accounting principle		675,000
Income Taxes		230,000
Income before cumulative effect of change in accounting principle		445,000
Cumulative effect of change in accounting principle, net of tax of $10,000		*65,000*
Net income		380,000

THE SAMPLE – Gathering Data

The sample included 25 companies. I acquired my data from the CD-ROM Disclosure software. It contains companies whose common stock is traded publicly. It contained a list of 91 companies that mentioned the words "asset impairment" in the annual report. The time period of the reports was from December of 1995 to July of 1996. I randomly selected 25 companies. Companies names were written on little pieces of paper and placed into a closed container. The container was shaken after each selection and the selections were not replaced. Each selection was verified not to be a service company. Further each selection was required to mention asset impairment in the latest annual data and not only in comparative data. During selection I through out any companies that were service companies. I excluded service companies, because there are other standards for impairment loss that service companies must follow besides SFAS

121. There were about six that were disregarded. Also, one company was thrown out of the sample, because the footnotes discussed assets written down in the previous year only. There was no mention of the current year in regards to the impairment of assets.

Before I started to gather data, I started a list of items that I used in comparing the 25 different companies. Through out the gathering process this list of items was continuously changed and updated. The final list included the following items:

- company name,
- year end,
- type of business,
- type of assets impaired,
- total assets,
- net income before tax and extraordinary items,
- amount of impairment,
- written-down goodwill,
- use of SFAS 121,
- early adoption of SFAS 121,
- impairment loss on assets "to be held and used" or "to be disposed of",
- written-down amount disclosed as a separate line item in the income statement,
- disclosure in footnotes,
- how many lines in footnotes relate to asset impairment,
- impairment loss included in which numbered footnote,
- impairment loss included in which paragraph of the above specified footnote,
- SFAS 121 impact this year's or next year's financial statements,

- how many lines mention asset impairment in the management representation letter,
- which paragraph mentioned asset impairment in the management representation letter, and
- total number of paragraphs in the management representation letter.

The year ends and types of business were noted in order to investigate a relationship with the early adoption of SFAS 121 and the impact on either this year's or next year's financial statements. The amount of total assets and the amount of impairment as a percentage of total assets were analyzed to discover relationships. To determine the materiality level which requires the disclosure of an asset impairment, the amount of the asset impairment was divided by the amount of net income before income tax and extraordinary items. The importance that management places on the impairment of assets was analyzed by looking at the length and the location of the discussions both in the management representation letter and the footnotes to the financial statements. Further it was compared to the decision of some companies to adopt the standard early. The type of assets impaired and the classification of the asset impairment ("to be held" or "to be disposed of") were analyzed for relationships. Companies which wrote-down goodwill were compared to see if a relationship exists with the amount of total assets. The information gathered in regards to the 25 companies is displayed in Table 2, Table 3, Table 4, and Table 5.

ANALYSIS

I believed that maybe the date of the companys' year ends could be related to adopting SFAS 121 early. The results of Table 2 showed that 50% (7 out of 14) of the companies with the year end of December 31, 1996 did adopt SFAS 121 early. Both companies with year ends in January did adopt SFAS 121 early. One of the four companies with a year end in February adopted SFAS 121 early. Two of the three companies using March 31 as their year end adopted SFAS 121 early. Both companies that had later year ends did not use SFAS 121 earlier than required.

I expected to see a relationship between the type of business, the early adoption of SFAS 121, and expected impact of using SFAS 121. I categorized the companies into seven classes. The results are displayed in Table 6. Only one of the three of the food-related companies have adopted early. Only one of four of the technology-related companies adopted early. Two of the three of the clothing-related companies are using SFAS 121. Two of four of the metals-related, two of three of the oil/gas-related, three of four of the printing-related have adopted SFAS 121 early. It was interesting to see that the companies who have adopted SFAS 121 show mixed results on why SFAS 121 was adopted early. The food-related, clothing-related, and one of the oil/gas-related companies stated that by using SFAS 121 in this reporting period the company will have different financial results than by using its previous methods. However, the technology-related, metals-related, printing-related, and one of the oil/gas-related companies have adopted SFAS 121 early without any significant changes to their financials.

Next I compared the amount of total assets, amount of asset impairment and goodwill. The following diagram shows the results from comparing the amount of impairment to the amount of total assets (detailed in Table 3).

Amount of total assets	% of impairment of total assets
up to $1 million	2.21%
$1 million to $5 million	2.95%
$5 million to $20 million	3.66%
Over $20 million	0.74%

It was interesting to note that the companies with over 20 million in total assets recorded so much a smaller percentage of impairment than even companies with less than $1 million in total assets. Both of the companies who wrote-down goodwill had total assets in the range of $1 million to $5 million.

SFAS 121 states that disclosure is required if the amount of the asset impairment is material. However, the statement does not define or describe materiality. Therefore, materiality is determined by judgement. To see what these companies determined to be material, I divided the amount of the asset impairment by the amount of net income before income tax and extraordinary items (amounts obtained from Table 3). Six of the eight companies that reported a loss before income tax and extraordinary items reported asset impairment for the current year. With the exception of Calgene Inc. New which had a -16084%, the other five companies averaged -167%. These numbers were determined by dividing the amount of asset impairment by the amount net income/(loss) before income tax and extraordinary items. Eight of the seventeen companies which reported net income before income tax and extraordinary items also reported an impairment of assets. With the exception of International Business Machines Corp. (IBM), the rest of the seven companies reported an average of 42%. IBM's percentage is 143% which is much higher than that of the other companies. The average of the rest of the companies of the amount of disclosed asset impairment is about 42% of net income before income taxes and extraordinary items. Therefore, it appears that the normal average of a material amount that must be disclosed is about 42%.

The significance of asset impairment can also be judged by looking at the management representation letter. Significance is the importance that management places on the impairment of assets. I expected that the companies would discuss SFAS 121 and its impact in detail. Initially I was not expecting to see much different between companies who did and did not adopt SFAS 121 early. However, there were different results for both types of companies. I looked at management's treatment of this issue separately for companies who did and who did not adopt SFAS 121. It seems that management who adopted SFAS 121 early felt that the asset impairment issue is of greater importance than management who did not adopt the standard early. Table 5 shows that management who did adopt early discussed the issue in greater length and included it closer to the beginning of the letter.

The results of the analysis of the management representation letter are displayed in Table 7. For the companies who *did not* adopt SFAS 121 early, the average number of lines in the management representation letter is eight. On average the management of these companies chose to report the asset impairment issue in the first half of the management representation letter. For the companies who *did* adopt SFAS 121 early, the average number of lines in the management representation letter is ten, which is two lines more on average than companies who did not adopt early. On average, the management of these companies discussed the asset impairment issue within the first third of the letter.

I also looked at the footnote disclosure for the asset impairment issue. Of the fourteen companies who did report impairment in the footnotes, only two companies disclosed the amount as a separate line item disclosure in the income statement (see Table 4). Only one of the twenty four companies did not mention the asset impairment issue in the footnotes. SuperValue Inc was this company. SuperValue did not have an asset impairment, but it did discuss the issue in the management representation letter. SuperValue has not yet adopted SFAS 121, and management does not believe that the adoption of SFAS 121 will have a different impact on the company's financials. Usually management of the other companies discussed this issue within the first two or three footnote disclosures. The following table shows a comparison of the average location of the discussion in the footnotes and the amount of lines used to describe asset impairments.

Lines in footnotes describing asset impairment	Average paragraph location*
0 to 10	10.2
11 to 20	7.5
21 to 30	2.5**
more than 30	1

*The *average paragraph location* was determined by dividing the paragraph location where asset impairment was mentioned by the total number of paragraphs in the financial statement footnotes.

** Rentrak Corporation paragraph location was not considered in this average, because it was greatly different than the other numbers in this range.

The above data implies that when management feels that the asset impairment issue is more deserving of a lengthier discussion it will be included closer to the beginning of the footnote disclosure section.

Table 3 shows that only three companies came out and stated the type of asset that was impaired. Of the fourteen companies which disclosed an impaired amount, only two companies stated that it has both to be disposed of assets and assets to be held and used. One company stated that it was writing-down assets to be disposed of.

Conclusion

SFAS 121 is a new standard devoted to the issue of impairment of long-lived assets. Impairment loss occurs when the carrying amount is not expected to be recovered. When SFAS 121 was issued, early adoption was suggested but not required for fiscal years beginning before December 15, 1995. Although there are some similarities, the standard sets some different rules for assets "to be held and used" and assets "to be disposed of." Since the standard does not identify a materiality level, it remains at the discretion of management.

A sample of 25 companies was chosen from the CD-ROM Disclosure Software. The sample was analyzed and compared on a list of items to identify relationship between the items.

I was surprised to see how many companies actually disclosed asset impairments and how many adopted SFAS 121 early. It seems that companies that have the earlier year ends adopted SFAS 121 early as opposed to companies that have later year ends. The companies who have adopted SFAS 121 show mixed results on why SFAS 121 was adopted early. Certain groups of companies like the food-related, clothing-related, and one of the oil/gas-related companies stated that by using SFAS 121 in this reporting period the company will have different financial results than by using its previous methods. However, some companies like the technology-related, metals-related, printing-related, and one of the oil/gas-related companies have adopted SFAS 121 early without any significant changes to their financials. In this study as the total amount of assets increased, the percentage of impairment also increased up to the $20 million level. After the total assets exceeded $20 million, the percentage of impairment of total assets decreased by almost 3%. The materiality level for required disclosure of an asset impairment in this study appears to be 42% of the net income before income taxes and extraordinary items.

I also evaluated the significance that management placed on asset impairment by comparing a number of factors. Management who did adopt SFAS 121 early discussed the issue in greater length and included it closer to the beginning of the management representation letter. For companies who did adopt SFAS 121, the average number of lines in the management representation letter was two lines more on average than companies who did not adopt SFAS 121. On average the management of these companies discussed the asset impairment issue within the first third of the letter. When management felt that the asset impairment issue was more deserving of a lengthier discussion, it was included closer to the beginning of the footnote disclosure section.

TABLE 1: FINANCIAL STATEMENT DISCLOSURES

For SFAS 121

Assets to be Held and Used:	Assets to be Disposed of:
▪ Period of the impairment write-down	▪ Period during which assets are held
▪ A description of the impaired assets and the facts and circumstances leading to the impairment	▪ A description of assets to be disposed of, the facts and circumstances leading to the expected disposal, the expected disposal date, and the carrying amount of those assets
▪ The amount of the impairment loss and how fair value was determined	▪ If applicable, the business segment(s) in which assets to be disposed of are held
▪ The caption in the income statement or the statement of activities in which the impairment loss has not been presented as a separate caption or reported parenthetically on the face of the statement	▪ The loss, if any, resulting from the application of this statement
▪ If applicable, the business segment(s) affected	▪ The gain or loss, if any, resulting from the changes in the carrying amounts of assets to be disposed of that arises from the application of this statement
	▪ The caption in the income statement or statement of activities in which the above gains or losses are aggregated if those gains or losses have not been presented as a separate caption or reported parenthetically on the face of the statement
	▪ The results of operations for assets to be disposed of to the extent that those results are included in the entity's results of operations for the period and can be identified

Information from paragraphs 14 and 19 of SFAS 121.

TABLE 2: Research Results Displayed

No. Items Name of Company	1 year-end	2 Type of Business	3 Type of Assets Written Down
Amerada Hess Corp	12/31/95	Exploration & production of crude oil and natural gas	refining facility, oil and gas producing property, ocean going vessels
American Greetings Corp	2/29/96	manufacturer & sale of greeting cards	machines, related goodwill, other intangibles
Aztec Manufacturing Co	2/29/96	Manufacturer of electrical products	inventory
Brush Wellman Inc	12/31/95	Manufacturer of engineered steel	
Calgene Inc New	6/30/96	Biotechnology	consolidation of facilities & equipment, and technology licenses
Chevron	12/31/95	Crude oil & natural gas	oil & gas producing properties
Cleveland Cliffs Inc	12/31/95	iron ore pellets-produce	
Dole Food Co Inc	12/31/95	Process & distribute branded foods	agricultural and resort properties
Exide Corp	3/31/96	Manufacturer of replacement batteries	unamortized deferred financing costs
Helen of Troy LTD	2/29/96	Cosmetics	
International Business Machines Corp	12/31/95	Computer hardware and software	software products
Kellogg Co	12/31/95	Cereal and grain-based foods	operating assets
Kinetic Concepts Inc	12/31/95	rent medical patient support services	
Kmart Corp	1/31/96	Mass merchandise retailers	Builder's Square and international operations
Merisel Inc	12/31/95	Microcomputer products	intangible assets
Multi Color Corp	3/31/96	Conventional business label	printing and finishing equipment
P H Glatfelter Co	12/31/95	Printing papers and tobacco	prior year-ppe and inventory
Pegasus Gold Inc	12/31/95	gold production	mine and development property
Rea Gold Corp	12/31/95	Gold	
Rentrak Corp	3/31/96	Video cassette sales	intangible assets
Stevens International Inc	12/31/95	Packaging and printing systems	
SuperValue Inc	2/24/96	Food distribution	
TSX Corp	4/30/96	CATV fiber and RF distribution products	
Woolworth Corp	1/27/96	Clothing, footwear, jewelry	inventory, disposal of operations, acquiring new stores,
Xplor Corp	12/31/95	oil and gas	nonoperating wells and pipelines

TABLE 3: Research Results Displayed - continued

No. Items / Name of Company	4 total Assets	5 Net Income b/4 Tax & extraord.	6 Amount of Impairment	7 good-Will	8 use 121	9 early adoption	10 Use or Dispose
Amerada Hess Corp	7,756,370,000	-352,649,000	584,161,000		yes	yes	
American Greetings Corp	2,005,832,000	175,009,000	52,061,000	Yes	yes	yes	
Aztec Manufacturing Co	42,621,310	4,267,361	0		no	no	
Brush Wellman Inc	331,853,000	27,433,000	0		no	no	
Calgene Inc New	233,302,000	-96,993	15,600,000		no	no	both
Chevron	34,330,000,000	1,789,000,000	358,000,000		yes	yes	
Cleveland Cliffs Inc	6,446,000,000	71,600,000	0		yes	yes	
Dole Food Co Inc	2,442,192,000	175,824,000	103,800,000		yes	yes	Dispose
Exide Corp	2,711,429,000	6,730,000	9,600,000		no	no	
Helen of Troy LTD	154,588,000	16,847,000	0		no	no	
International Business Machines Corp	80,292,000,000	7,813,000	344,000,000		yes	yes	
Kellogg Co	4,414,600,000	796,000,000	106,500,000		no	no	
Kinetic Concepts Inc	243,726,000	48,346,000	0		no	no	
Kmart Corp	15,397,000,000	-750,000,000	532,000,000		yes	yes	
Merisel Inc	1,230,334,000	-105,690,000	51,400,000		no	no	
Multi Color Corp	30,454,000	1,154,000	112,000		yes	yes	
P H Glatfelter Co	673,107,000	107,612,000	prior year		no	no	
Pegasus Gold Inc	580,241,000	-3,532,000	0		yes	yes	
Rea Gold Corp	83,053,000	-2,900,000	0		no	no	
Rentrak Corp	56,252,000	-2,080,000	9,300,000		yes	yes	
Stevens International Inc	117,647,000	5,959,000	0		yes	yes	
SuperValue Inc	4,183,503,000	267,692,000	0		no	no	
TSX Corp	69,077,000	22,052,000	0		no	no	
Woolworth Corp	3,506,000,000	-233,000,000	241,000,000	24 mil	yes	yes	both
Xplor Corp	5,867,000	1,531,000	304,000		no	no	

TABLE 4: Research Results Displayed - continued

No. Items Name of Company	11 Disclosure-Line Items	12 Disclosure-Footnotes	12 How many Lines in footnotes	13 Which note in footnotes	14 which paragraph in footnotes
Amerada Hess Corp	yes	yes	36	2	1
American Greetings Corp	yes	yes	11	2	1
Aztec Manufacturing Co	no	yes	11	1	9
Brush Wellman Inc	no	yes	10	1	13
Calgene Inc New	no	yes	13	8	1
Chevron	no	yes	31	3	1
Cleveland Cliffs Inc	no	yes	10	1	1
Dole Food Co Inc	no	yes	22	4	4
Exide Corp	no	yes	8	1	19
Helen of Troy LTD	no	yes	10	1	15
International Business Machines Corp	no	yes	6	2	3
Kellogg Co	no	yes	8	4	5
Kinetic Concepts Inc	no	yes	12	1	22
Kmart Corp	no	yes	11	5	1
Merisel Inc	no	yes	18	3	1
Multi Color Corp	no	yes	11	1	6
P H Glatfelter Co	no	yes	26	2	1
Pegasus Gold Inc	no	yes	10	1	9
Rea Gold Corp	no	yes	13	2	19
Rentrak Corp	no	yes	29	1	20,22,34
Stevens International Inc	no	yes	4	1	7
SuperValue Inc	no	no	0	-	-
TSX Corp	no	yes	9	1	27
Woolworth Corp	no	yes	31	2	1
Xplor Corp	no	yes	9	2	3

TABLE 5: Research Results Displayed - continued

No. Items / Name of Company	15 Mgmt Rep Letter How many lines	16 which paragraph in mgmt rep letter	17 total paragraphs in mgmt rep letter	18 this or next year different impact?
Amerada Hess Corp	6	3	28	Yes
American Greetings Corp	19	7	23	No comment
Aztec Manufacturing Co	1	12	20	No
Brush Wellman Inc	13			No comment
Calgene Inc New	20	8	28	No comment
Chevron	23	34	85	No comment
Cleveland Cliffs Inc	0	-	-	No
Dole Food Co Inc	20	4	24	Yes
Exide Corp	4	9	25	No
Helen of Troy LTD	10	15	18	No
International Business Machines Corp	4	22	77	No
Kellogg Co	9	39	40	No
Kinetic Concepts Inc	7	28	58	No
Kmart Corp	12	8	56	Yes
Merisel Inc	13	6	54	No comment
Multi Color Corp	25	11,22	34	No comment
P H Glatfelter Co	23	26	33	No comment
Pegasus Gold Inc	4	1	40	No
Rea Gold Corp	0	-	-	No comment
Rentrak Corp	8	18,21	53	No
Stevens International Inc	9	32	32	No
SuperValue Inc	6	34	37	No
TSX Corp	0	-	-	No
Woolworth Corp	43	3,15,20,23,26,31, 35,55,	57	Yes
Xplor Corp	0	-	-	No

TABLE 6: Impact of the Type of Business On the Use of SFAS 121

Items Name of Company	Type of Business	use 121	this or next year different impact?
Food-related			
Dole Food Co Inc	Process & distribute branded foods	Yes	yes
Kellogg Co	Cereal and grain-based foods	No	no
SuperValue Inc	Food distribution	No	no
Technology-related			
International Business Machines Corp	computer hardware and software	Yes	no
TSX Corp	CATV fiber and RF distribution products	No	no
Calgene Inc New	biotechnology	No	no comment
Aztec Manufacturing Co	manufacturer of electrical products	No	no
Merisel Inc	microcomputer products	No	no comment
Clothing-related			
Woolworth Corp	clothing, footwear, jewelry	yes	yes
Kmart Corp	mass merchandise retailers	yes	yes
Helen of Troy LTD	cosmetics	no	no
Metals-related			
Pegasus Gold Inc	gold production	yes	no
Cleveland Cliffs Inc	iron ore pellets-produce	yes	no
Rea Gold Corp	gold	no	no comment
Brush Wellman Inc	manufacturer of engineered steel	no	no comment
Oil/Gas-related			
Chevron	crude oil & natural gas	yes	no comment
Amerada Hess Corp	exploration & production of crude oil and natural gas	yes	yes
Xplor Corp	oil and gas	no	no
Printing-related			
Multi Color Corp	conventional business label	yes	no comment
American Greetings Corp	manufacturer & sale of greeting cards	yes	no comment
Stevens International Inc	packaging and printing systems	yes	no
P H Glatfelter Co	printing papers and tobacco	no	no comment
Miscellaneous			
Rentrak Corp	video cassette sales	yes	no
Kinetic Concepts Inc	sell & rent medical patient support services	no	no
Exide Corp	manufacturer of replacement batteries	no	no

TABLE 7: Analysis of Management Representation Letter

Name of Company / Items	Early adoption	Mgmt Rep Letter How many lines	Location *
Rea Gold Corp	no	0	
TSX Corp	no	0	
Xplor Corp	no	0	
Aztec Manufacturing Co	no	1	0.60
Exide Corp	no	4	0.36
SuperValue Inc	no	6	0.92
Kinetic Concepts Inc	no	7	0.48
Kellogg Co	no	9	0.98
Helen of Troy LTD	no	10	0.83
Merisel Inc	no	13	0.11
Brush Wellman Inc	no	13	0.18
Calgene Inc New	no	20	0.29
P H Glatfelter Co	no	23	0.79
	average	**8.15**	**0.55**
Cleveland Cliffs Inc	yes	0	
Pegasus Gold Inc	yes	4	0.03
International Business Machines Corp	yes	4	0.29
Amerada Hess Corp	yes	6	0.11
Rentrak Corp	yes	8	0.38
Stevens International Inc	yes	9	1.00
Kmart Corp	yes	12	0.14
American Greetings Corp	yes	19	0.30
Dole Food Co Inc	yes	20	0.17
Chevron	yes	23	0.40
Multi Color Corp	yes	25	0.44
	average	**10.83**	**0.33**
Woolworth Corp	yes	43	**

* Location indicates where in the letter the issue was discussed. Location was determined by dividing in which paragraph SFAS 121 was discussed by the total paragraphs in the management representation letter.

** Woolworth Corporation is displayed separately from the rest of the companies which did adopt SFAS 121 early, because the management representation letter talks about asset impairments throughout the letter. It talks about it in paragraphs 3, 15, 20, 23, 26, 31, 35, and 55. The total amount of paragraphs in the letter is 57.

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